

Federal Bank

BUY

Stressed assets stood at 2.62% vs 2.24% QoQ

Summary

Federal Bank reported rise in Covid specific restructured assets to 2.5% vs 1.8% QoQ led by retail loans (specifically home loans). However asset quality improved as GNPA stood at 3.24% vs 3.5% QoQ led by higher recoveries and upgrades (Rs.4.2bn) as compared to slippages (Rs.3bn). Stressed book % of assets which was declining for last 3 years spiked to 2.62% vs 2.24% QoQ. Credit growth improved to 10% YoY vs 7% YoY (Q1FY22); Deposits growth stood at 10% YoY vs 9% YoY (Q2FY22). NII grew by 4% QoQ led by improvement in NIMs. Operating profit declined by 24% QOQ due to change in accounting treatment for recovery in written off accounts. Provisions declined by 62% QoQ led to strong profitability growth (up 25% QoQ). Collection efficiency improved to 96%. We have moved to FY24E estimates and maintained BUY rating with the new target price of Rs.123 (earlier 102) based on P/BV of 1.2x FY24.

Key Highlights and Investment Rationale

- Credit and Deposit growth improved:** Loan book grew by 10% YoY (3% QoQ) as against 7% YoY (Q1FY22). Retail/Agri/SME grew at 12%/YoY/20%/YoY/11%/YoY respectively, whereas corporate book grew by 4% YoY. Deposits grew at 10% YoY with improvement in CASA to 36.2% vs 33.7% YoY.
- Asset quality improved, restructured book saw uptick:** Asset quality improved as GNPA stood at 3.24% vs 3.5% QoQ and NNPA at 1.12% vs 1.23% QoQ. Slippage ratio stood at 1% (annualized) vs 2% QoQ. A Covid Specific Restructuring asset stands at 2.5% (vs 1.8% earlier) of total advances. Stressed book % of assets saw uptick to 2.6% vs 1.24% QoQ due to 2nd Covid wave.
- NIMs remain stable:** NIMs improved by 5bps QoQ to 3.2% led by decline in cost of deposits (down 13bps QoQ) higher than decline in yields (down 4bps QoQ).
- Outlook:** Bank had enough opportunity to grow in front of fee income in terms of cross sell as its customer base stands at 8mn. We believe there is potential for an improvement of 5-10bps every year in ROA post flagging of Covid -19 impacts. We expect second wave impact will also be lower as compared to its peer group.

TP	Rs123
CMP	Rs104
Potential upside / downside	18%
Previous Rating	BUY

V/s Consensus

EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	9.5	11.0	13.6
Consensus	9.3	11.8	14.4
% difference	2.7	(7.0)	(5.6)

Shareholding Pattern (%)

Promoters	0.0
FII	25.9
DII	42.1
Public	32.0

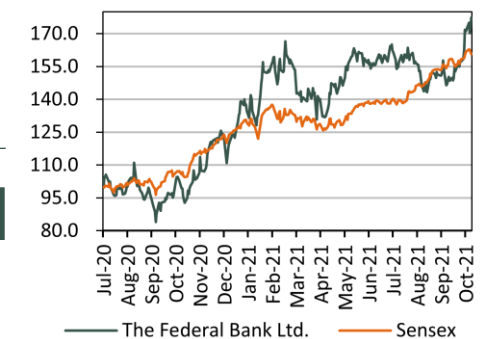
Price Performance (%)

	-1m	-3m	-12m
Absolute	28.3	23.5	84.0
Rel to Sensex	25.1	8.4	34.0

Key Stock Data

Bloomberg / Reuters	FB IN / FED.BO
Sector	Banking
Shares o/s (mn)	2,102
Market cap. (Rs mn)	2,18,667
Market cap. (US\$ mn)	2,902
3-m daily avg trd value (Rs mn)	124.8
52-week high / low	Rs98 / 50
Sensex / Nifty	60,822 / 18,115

Relative to Sensex (%)



Financial snapshot

Year	FY2020	FY2021	FY2022E	FY2023E	FY2024E
NII	46,489	55,337	60,479	66,142	73,609
Net Profit	15,428	15,903	19,917	23,200	28,537
EPS (Rs)	7.7	8.0	9.5	11.0	13.6
ABV (Rs)	64.8	72.9	80.8	91.3	103.1
PER (x)	13.4	13.1	11.0	9.4	7.7
P/ABV (x)	1.6	1.4	1.3	1.1	1.0
ROE (%)	11.1	10.4	11.5	11.8	13.1
ROA (%)	0.9	0.8	0.9	1.0	1.1
GNPA (%)	2.8	3.4	3.5	3.3	3.1
NNPA (%)	1.3	1.2	1.1	0.8	0.7
CAR (%)	14.4	14.6	15.0	14.7	14.7

Source: IDBI Capital Research

Conference Call Highlights

Management Highlights

- Accounting Changes - Recovery from other assets now would be part of Provision write-back, earlier part of other income (netted against other income).
- Aim to get ROA for FY22 to exit around 1%, 1.2-1.5% within next 2 years.
- Challenge in terms of pension cost.
- Bank building an internship model to train employees to reduce overall cost structure.
- Bank working on digital hybrid model to be customer centric.

NIMs

- NIMs are result of business mix, low cost deposits, reversal of interest income.
- Management estimates broad range of 3.20%-3.25%.

ROA

- The bank aims to get ROA for FY22 to exit around 1%, 1.2-1.5% within next 2 years.
- A mix of credit cards, commercial banking, Gold loan lending should support.

Business Focus

- The bank aims to create an AUM scale in next 2 years for distribution of 12-15 lakh credit cards.
- CV vehicle financing in plans to build Rs.5000-6000 cr, Commercial and Business lending to reach a potential to reach Rs.45,000 cr.

Asset quality

- The slippages during the quarter were close to nil.
- Slippage on the UAE Exchange account, the bank has not recovered any amount, however the bank stated that the recovery has been fully provided.
- The bank aims to have a credit cost structure of 70 to 80 bps for FY22.

Restructuring

- Restructuring amount is of Rs. 3,563 crores and COVID related restructuring stood at Rs. 3,423 crores.
- The SMA account is approximately 4.0%, with an improvement of 50 to 60 bps QoQ.
- ECLGS book stands at Rs.2700-3000 crores, of which 17% of book has come in demand.
- Restructuring moratorium maximum is for 24 months.
- Collection efficiency was strong during the quarter.
- 95% of collection is similar to the general book.

Liquidity

- Maintains LCR above 200%.
- Treasury Operations (a function of arbitrage in money market)
- No long term borrowing in the balance sheet.

Remittance

- Increased market share in this space from 17.5% to 20% currently (6% 7-8 years back)
- Bank acts as a facilitator.
- Function of exchange rate (Depreciation in rupee leads to further remittance).

Credit Card

- Fintech collaboration has helped in opening 3 lakh accounts, with 3,000-4,000 accounts opened on a normal day, 7,500 (approximately) currently.
- Partnership with FPL helping in credit card business. Acquisition is done by the partner and booking done by Federal Bank.

Other Highlights

- Cost/Income aim to be 50% next year, by FY22-23, it is targeting 52-53%.
- CASA growing at 50-60 bps.
- Employee net addition in last 4 years has been 600 people.

- Fee Income will come under debit card for income.
- Partnership with ICICI Securities for trading account (Deposit income with ICICI Securities and the float income remains with Federal Bank).
- Fed Fina has a focused small ticket size loan book with focus on LAP, Gold loan, small business, with a Rs.5000 crore loan book, aiming for a 30% growth in a year.
- Bank plans to stay out of lending to Hospitality sector.
- H2 FY22 growth would be higher than H1 FY22, somewhere in teens.

Exhibit 1: Quarterly Snapshot

(Rs mn)

Year-end: March	Q2FY22	Q2FY21	Q1FY22	YoY (%)	QoQ (%)
Interest Income	33,793	34,879	33,557	(3.1)	0.7
Interest Expenses	18,998	21,080	19,373	(9.9)	(1.9)
Net Interest Income	14,794	13,799	14,184	7.2	4.3
NIM (%)	3.2	3.1	3.2	7 bps	5 bps
Non-Interest Income	4,440	5,093	6,502	(12.8)	(31.7)
Operating Income	19,234	18,892	20,686	1.8	(7.0)
Staff Cost	5,719	4,875	5,283	17.3	8.3
Other Op Exp	4,871	3,952	4,051	23.2	20.2
Total Operating Expenses	10,590	8,827	9,334	20.0	13.5
<i>Cost to Income (%)</i>	55.1	46.7	45.1	833 bps	994 bps
Operating Profit	8,644	10,065	11,352	(14.1)	(23.9)
Provisions	2,450	5,921	6,418	(58.6)	(61.8)
PBT	6,194	4,144	4,934	49.5	25.5
Tax	1,592	1,068	1,261	49.1	26.2
<i>-effective tax rate</i>	25.7	25.8	25.6	-7 bps	14 bps
PAT	4,602	3,076	3,673	49.6	25.3
EPS (Rs)	2.2	1.5	1.8	42.0	19.0
BV (Rs)	84.4	76.4	82.6	10.4	2.1
Deposits	17,19,948	15,67,474	16,93,930	9.7	1.5
Advances	13,44,046	12,29,120	12,97,650	9.4	3.6

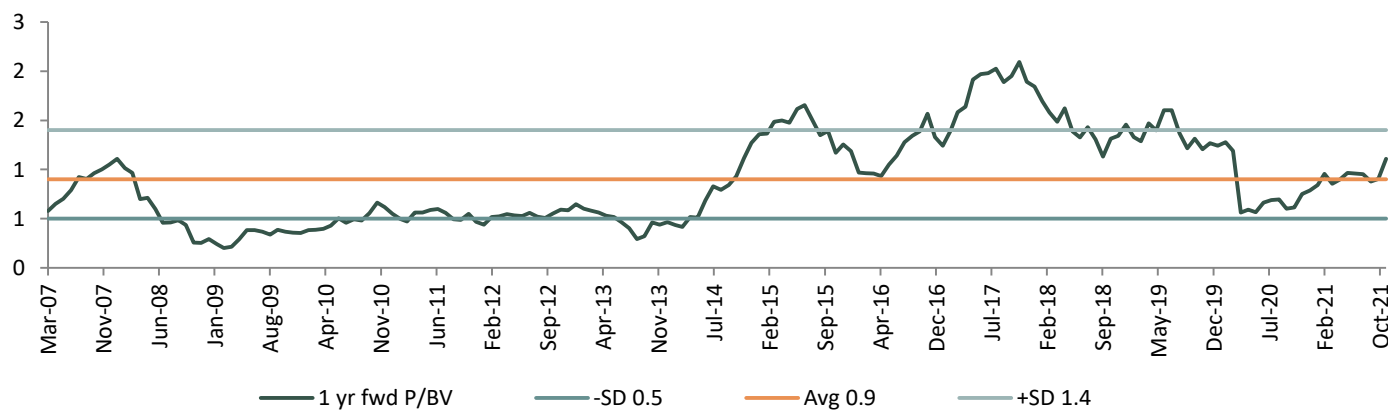
Source: Company; IDBI Capital Research

Exhibit 2: ROE Decomposition

(%)	FY20	FY21	FY22	FY23E	FY24E
NII	2.73	2.90	2.87	2.83	2.82
Fees	0.78	0.70	0.72	0.59	0.59
Other Income	0.36	0.32	0.25	0.28	0.28
Net Revenue	3.87	3.92	3.84	3.71	3.69
Op.Exp	1.99	1.93	1.99	1.87	1.78
Op.Profit	1.89	1.98	1.85	1.84	1.91
Provisions	0.69	0.86	0.59	0.51	0.45
PBT	1.20	1.12	1.26	1.33	1.46
Tax	0.29	0.29	0.32	0.33	0.37
ROA	0.91	0.83	0.94	0.99	1.09
Leverage (x)	12.24	12.47	12.15	11.92	11.99
ROE	11.11	10.38	11.46	11.85	13.12

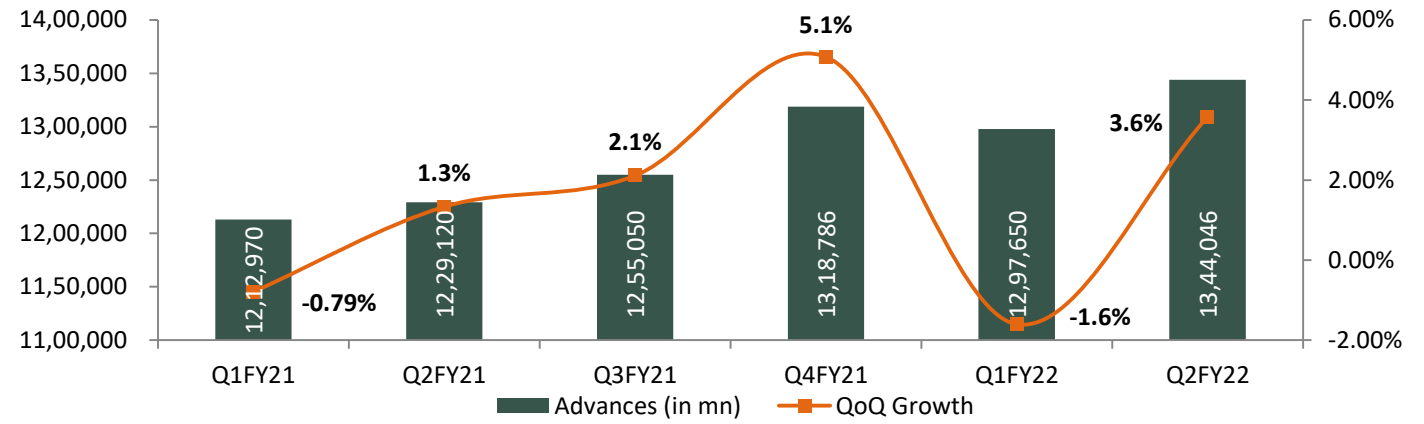
Source: Company; IDBI Capital Research

Exhibit 3: One-year forward P/ABV



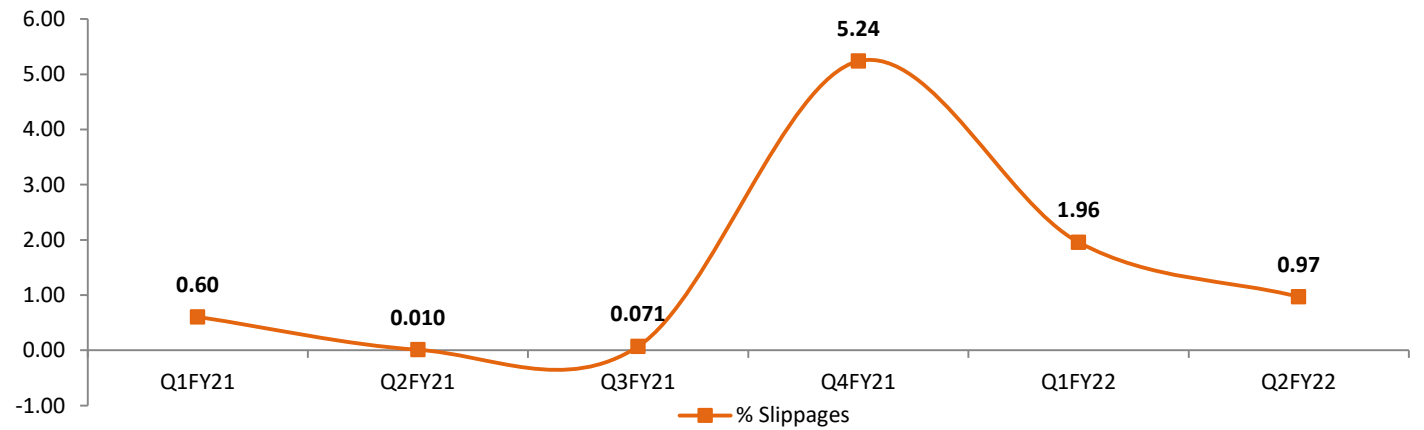
Source: Company; IDBI Capital Research

Exhibit 4: Advances growth has improved



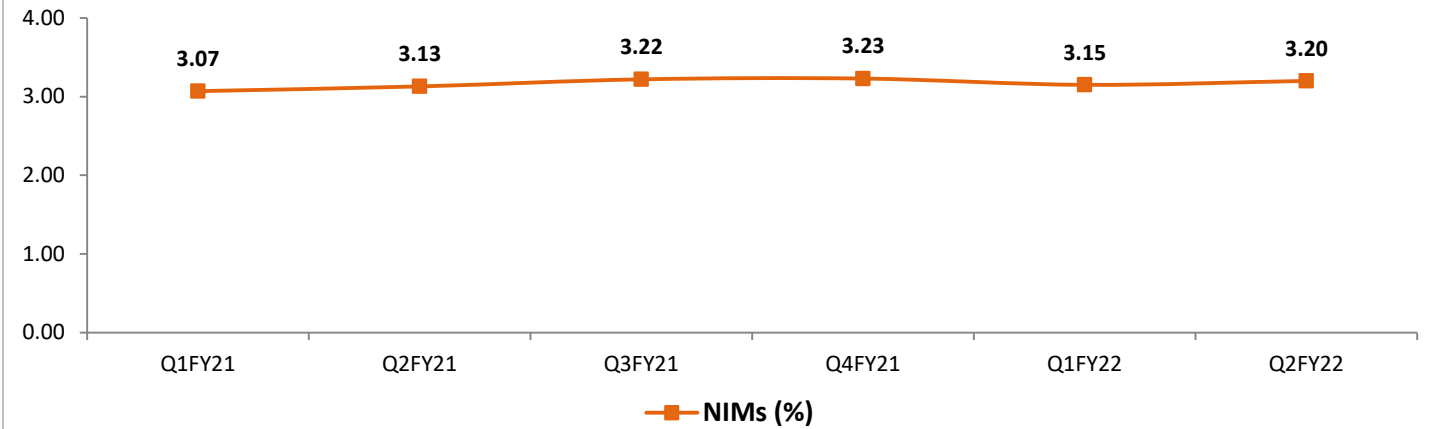
Source: Company; IDBI Capital Research

Exhibit 5: Slippage ratio has declined



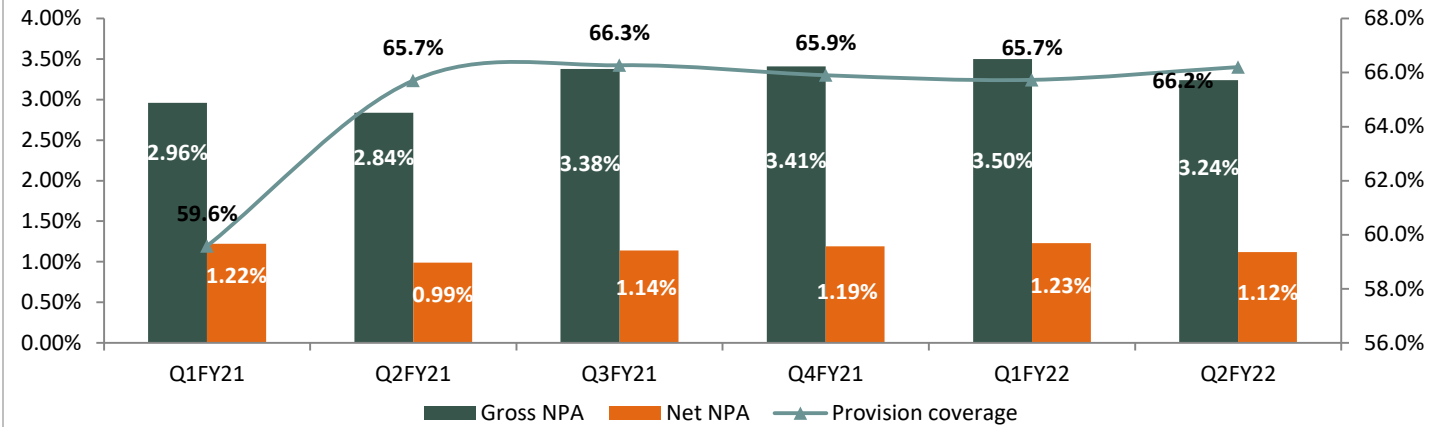
Source: Company; IDBI Capital Research

Exhibit 6: Net Interest margins guidance 3.2 – 3.25%



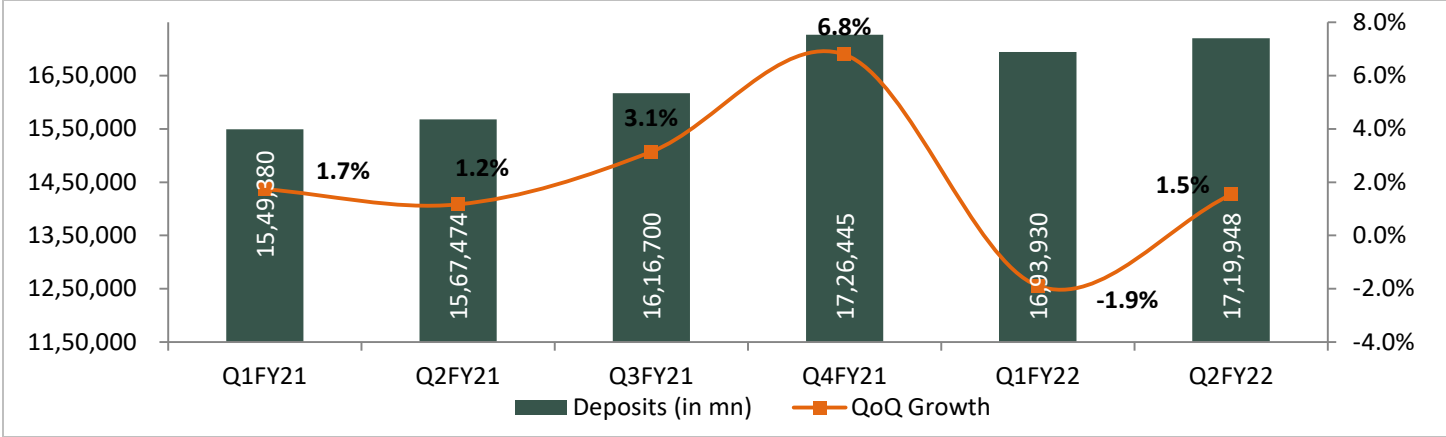
Source: Company; IDBI Capital Research

Exhibit 7: Stable asset quality



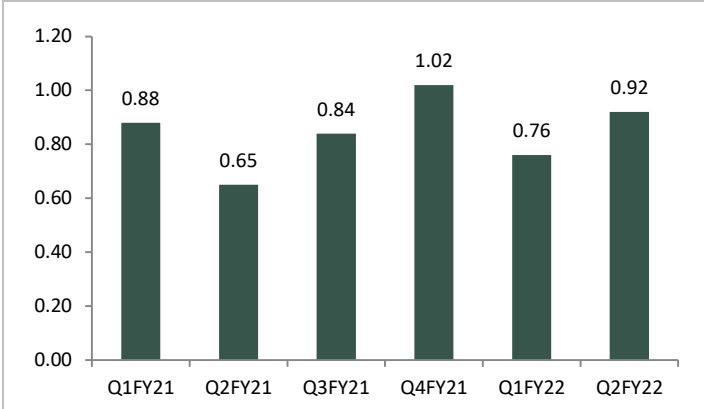
Source: Company; IDBI Capital Research

Exhibit 8: Deposits growth in line with advances growth



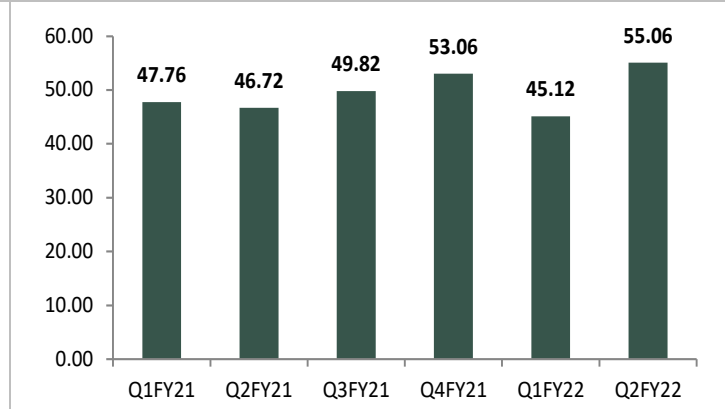
Source: Company; IDBI Capital Research

Exhibit 9: RoA tgt to exit 1% by FY22



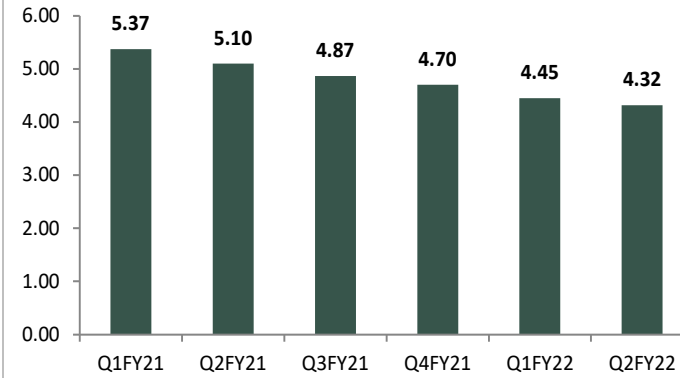
Source: Company; IDBI Capital Research

Exhibit 10: Cost to Income Ratio inched up



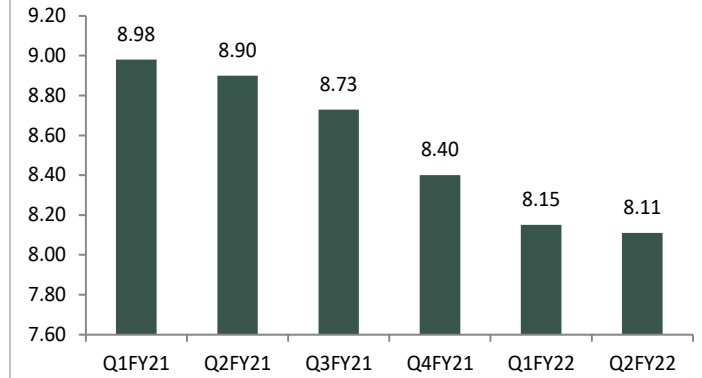
Source: Company; IDBI Capital Research

Exhibit 11: Cost of Deposits



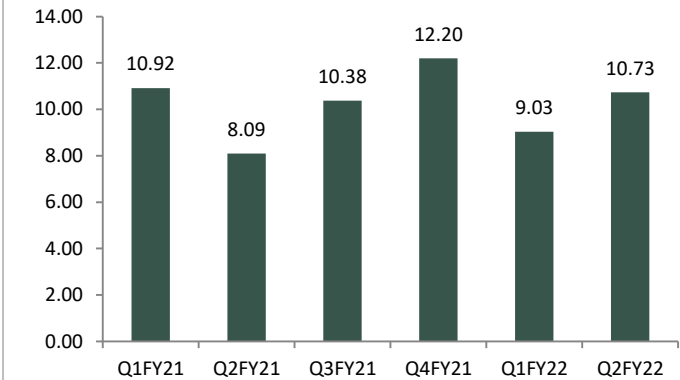
Source: Company; IDBI Capital Research

Exhibit 12: Yield on Advances



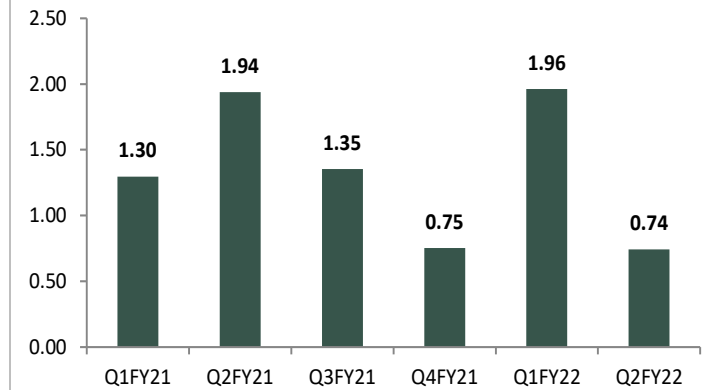
Source: Company; IDBI Capital Research

Exhibit 13: Return on Equity



Source: Company; IDBI Capital Research

Exhibit 14: Credit Cost



Source: Company; IDBI Capital Research

Exhibit 15: Cost to Assets also inched up	Exhibit 16: CAR remains comfortable																																										
<table border="1"> <caption>Exhibit 15: Cost to Assets</caption> <thead> <tr> <th>Quarter</th> <th>Cost to Assets</th> </tr> </thead> <tbody> <tr> <td>Q1FY21</td> <td>1.25</td> </tr> <tr> <td>Q2FY21</td> <td>1.26</td> </tr> <tr> <td>Q3FY21</td> <td>1.33</td> </tr> <tr> <td>Q4FY21</td> <td>1.35</td> </tr> <tr> <td>Q1FY22</td> <td>1.24</td> </tr> <tr> <td>Q2FY22</td> <td>1.40</td> </tr> </tbody> </table>	Quarter	Cost to Assets	Q1FY21	1.25	Q2FY21	1.26	Q3FY21	1.33	Q4FY21	1.35	Q1FY22	1.24	Q2FY22	1.40	<table border="1"> <caption>Exhibit 16: CAR Components</caption> <thead> <tr> <th>Quarter</th> <th>Base CAR</th> <th>Provisioning</th> <th>Total CAR</th> </tr> </thead> <tbody> <tr> <td>Q1FY21</td> <td>13.00%</td> <td>1.17%</td> <td>14.17%</td> </tr> <tr> <td>Q2FY21</td> <td>13.33%</td> <td>1.31%</td> <td>14.64%</td> </tr> <tr> <td>Q3FY21</td> <td>13.00%</td> <td>1.31%</td> <td>14.31%</td> </tr> <tr> <td>Q4FY21</td> <td>13.85%</td> <td>0.77%</td> <td>14.62%</td> </tr> <tr> <td>Q1FY22</td> <td>13.87%</td> <td>0.77%</td> <td>14.64%</td> </tr> <tr> <td>Q2FY22</td> <td>14.09%</td> <td>0.88%</td> <td>14.97%</td> </tr> </tbody> </table>	Quarter	Base CAR	Provisioning	Total CAR	Q1FY21	13.00%	1.17%	14.17%	Q2FY21	13.33%	1.31%	14.64%	Q3FY21	13.00%	1.31%	14.31%	Q4FY21	13.85%	0.77%	14.62%	Q1FY22	13.87%	0.77%	14.64%	Q2FY22	14.09%	0.88%	14.97%
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Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY21	FY22	FY23E	FY24E
Net interest income	55,337	60,479	66,142	73,609
Non-Interest Income	19,449	20,597	20,391	22,688
Operating Income	74,786	81,076	86,533	96,297
Operating expenses	36,917	42,009	43,596	46,520
Employee expenses	20,342	22,623	22,837	23,270
Other expenses	16,575	19,386	20,759	23,250
Pre-Provision Profit	37,869	39,067	42,937	49,776
Provision	16,496	12,450	11,934	11,641
PBT	21,373	26,616	31,003	38,136
Taxes	5,470	6,699	7,804	9,599
Net profit	15,903	19,917	23,200	28,537

Balance Sheet

(Rs mn)

Year-end: March	FY21	FY22	FY23E	FY24E
Capital	3,992	4,202	4,202	4,202
Reserves	1,57,243	1,82,121	2,01,119	2,25,454
Networth	1,61,235	1,86,323	2,05,321	2,29,656
Borrowings	90,685	90,344	91,233	1,09,066
Total Liab. & Equity	20,13,673	22,07,658	24,59,333	27,58,004
Cash	1,95,913	2,04,544	2,29,089	2,56,580
Investments	3,71,862	3,94,541	4,24,421	4,74,012
Advances	13,18,786	14,50,665	16,24,744	18,19,714
Other Assets	1,22,201	1,52,751	1,75,664	2,02,014
Total assets	20,13,673	22,07,658	24,59,333	27,58,004

Financial Ratios

(%)

Year-end: March	FY21	FY22	FY23E	FY24E
Growth				
Advances	7.9	10.0	12.0	12.0
NII	19.0	9.3	9.4	11.3
Pre-Provision Profit	18.2	3.2	9.9	15.9
Net Profit	3.1	25.2	16.5	23.0
Spreads				
Yield on Assets	8.0	7.9	7.9	7.9
Cost of Funds	4.8	4.7	4.7	4.7
NIM	3.2	3.2	3.2	3.2
Operating Efficiency				
Cost-to-Income	49.4	51.8	50.4	48.3
Cost-to-Assets	1.9	2.0	1.9	1.8
Asset Quality				
GNPA	3.4	3.5	3.3	3.1
NNPA	1.2	1.1	0.8	0.7
Provision Coverage	65.9	68.7	75.3	77.4
Credit Cost	1.3	0.9	0.8	0.7
Capital Adequacy				
CAR	14.6	15.0	14.7	14.7
Tier I	13.9	14.3	14.1	14.1
Valuation				
EPS	8.0	9.5	11.0	13.6
BV	80.8	88.7	97.7	109.3
P/E	13.1	11.0	9.4	7.7
P/BV	1.3	1.2	1.1	1.0
ROE	10.4	11.5	11.8	13.1
ROA	0.8	0.9	1.0	1.1
RORWA	1.5	1.7	1.7	1.9

Source: Company; IDBI Capital Research



Notes

Dealing

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Key to Ratings Stocks:**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

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